

**BOARD OF
SUPERVISORS:**

A Review of AT&T Broadband's
Franchise Fee Payments
July 1, 1998, Through June 30, 2000

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Audit Number 00029
November 20, 2001



Edward Harrington
Controller

Matthew H. Hymel
Chief Assistant Controller

November 20, 2001

Audit Number 00029

Board of Supervisors
City Hall, Room 244
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

President and Members:

The Controller's Audits Division presents its report concerning the review of franchise fee payments AT&T Broadband (AT&T) made to the City and County of San Francisco (City) to operate the cable television system within the City. AT&T is required to report its gross revenues arising from the operation of the cable television system each quarter and to pay 5 percent of the gross revenues as a franchise fee to the City. In addition, AT&T is required to make payments and cash grants for facilities and the support of public, educational, and governmental channels.

Reporting Period: July 1, 1998 through June 30, 2000


Franchise Fees and Grants Paid:	Franchise Fees	\$9,332,602
	Grants	<u>\$1,014,000</u>
	Total	\$10,346,602

Results:

AT&T paid its franchise fees to the City on a timely basis. In our opinion, AT&T correctly paid all franchise fees due to the City, even though AT&T did not follow the franchise agreement in reporting its advertising revenue. AT&T also correctly paid the required cash grants to the City. However, AT&T's current method of reporting advertising revenues does not comply with the procedures stated in the franchise agreement. Due to AT&T's unauthorized reporting changes, amounts paid cannot be verified according to the franchise language; however, AT&T's procedures do not appear to have resulted in an underpayment or overpayment of franchise fees on advertising revenues.

The responses of the Department of Telecommunications and Information Services and AT&T are attached to this report. The Controller's Audits Division will be working with the department to follow up on the status of the recommendation made in the report.

Respectfully submitted,


Edward Harrington
Controller



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INTRODUCTION

AT&T Broadband (AT&T), one of AT&T Corporation's business segments, operates the cable television system for the City and County of San Francisco (City). AT&T Corporation assumed control of Tele-Communications, Inc., the City's former cable television franchisee, on March 9, 1999. The City's cable television franchise ordinance (franchise agreement) requires AT&T to report its gross revenues arising from the operation of the cable television system each quarter and to pay 5 percent of the gross revenues as a franchise fee to the City. The franchise agreement defines gross revenues as payments or other consideration that AT&T received in connection with providing cable service in the City. AT&T's revenues include various subscriber fees, such as fees for basic cable services, expanded basic services, premium services, and pay per view, as well as revenues from shopping commissions and advertising sales.

The franchise agreement requires AT&T to make franchise fee payments to the City within 90 days after the end of each quarter. The franchise agreement also requires AT&T to make specified grant payments to the City over the term of the agreement.

SCOPE AND METHODOLOGY

The purpose of this audit was to determine whether AT&T correctly reported its gross revenues and correctly paid the City the franchise fees and grants due from July 1, 1998, through June 30, 2000. To determine whether AT&T correctly totaled its quarterly gross revenues, we checked the mathematical accuracy of AT&T's quarterly statements. We also assessed the timeliness of its franchise fee payments. To determine whether AT&T correctly reported gross revenues for the audit period, we tested, on a sample basis, AT&T's supporting records. As part of our review, we interviewed staff from AT&T, the Department of Telecommunications and Information Services, and the Office of the City Attorney.

AUDIT RESULTS

AT&T PAID ITS FRANCHISE FEES AND GRANT PAYMENTS

From July 1, 1998, through June 30, 2000, AT&T reported \$186,652,032 in cable service gross revenues and paid \$9,332,602 in franchise fees on a timely basis. In our opinion, AT&T correctly paid all franchise fees due to the City, even though AT&T did not follow the franchise agreement in reporting its advertising revenue, as discussed below. The table below shows the cable service gross revenues and franchise fees paid to the City for the audit period. In addition, AT&T is required to make payments and cash grants for facilities and the support of public, educational, and governmental channels. For the audit period, AT&T correctly paid \$1,014,000 in grant payments to the City.

TABLE

**Reported Gross Revenues and Franchise Fees Paid
July 1, 1998, Through June 30, 2000**

	Reported Gross Revenues	Franchise Fees Paid
July 1, 1998, through June 30, 1999	\$88,838,131	\$4,441,907 *
July 1, 1999, through June 30, 2000	97,813,901	4,890,695
Total	\$186,652,032	\$9,332,602

* As recommended by our franchise fee audit report issued in June 1999, AT&T reduced the June 1999 quarterly franchise fee payment by \$8,090 as a result of an overpayment in the franchise fees it paid in 1998.

AT&T'S METHOD OF REPORTING ADVERTISING REVENUES DOES NOT COMPLY WITH THE FRANCHISE AGREEMENT

AT&T did not obtain City approval for using a procedure different than stated in the franchise agreement to report advertising revenues to the City. The franchise agreement specifies how AT&T is to report advertising revenues to the City. According to AT&T Media Services director of accounting, these terms were applicable when Tele-Communications, Inc. was the franchisee and used Bay

Cable Advertising (BCA) as its agency to sell advertisements for cable television in the Bay Area. However, according to AT&T Media Services director of accounting, BCA was purchased by TCI. As a result, TCI and AT&T, after AT&T assumed control of TCI, used procedures different than stated in the agreement for determining advertising revenues. Nonetheless, according to a deputy director of the Department of Telecommunications and Information Services, AT&T did not consult with the City to obtain approval for using these different procedures. The deputy director also stated that AT&T should have sought the City's prior approval to use procedures different from the procedures stated in the franchise agreement. We reviewed AT&T's procedures for reporting advertising revenue to the City, and although the procedures appear to result in AT&T reporting to the City the intended amount of advertising revenues, AT&T should have obtained the City's approval for the reporting changes.

RECOMMENDATION

The Department of Telecommunications and Information Services should take any measures it deems appropriate in response to AT&T's noncompliance with its franchise obligations for reporting advertising revenues. AT&T should seek a franchise amendment to modify these obligations if it wishes to continue to report advertising revenues in a manner that does not comply with its current franchise obligations.

We conducted this review according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Staff: Ben Carlick, Audit Manager
Winnie Woo

DEPARTMENT OF TELECOMMUNICATIONS AND INFORMATION SERVICES RESPONSE TO THE AUDIT:

CITY AND COUNTY OF SAN FRANCISCO

DEPARTMENT OF TELECOMMUNICATIONS
AND INFORMATION SERVICES



Liza M. Lowery
Executive Director

Telephone: (415) 554-0801

October 25, 2001

Ed Harrington, Controller
City Hall – Room 316
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4694

Subject: **Audit Report of AT&T Broadband**

Dear ^{Ed} Controller Harrington:

This is in response to your September 28, 2001 request for my review and comments of the subject report.

Please be advised that I concur with your report, as revised, to reflect the suggestions made by the City Attorney's office.

Sincerely,

A handwritten signature in black ink, appearing to read "Liza Lowery", written over the word "Sincerely,".

Liza Lowery
Executive Director

cc: Denise Brady, Deputy Director of Policy, Planning & Compliance Division, DTIS
Julia Friedlander, Deputy City Attorney

AT&T BROADBAND RESPONSE TO THE AUDIT:



AT&T Broadband
P.O. Box 5147
San Ramon, CA 94583

November 7, 2001

Mr. Edward Harrington, Controller
City Hall – Room 316
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4694

Dear Mr. Harrington:

AT&T Broadband has reviewed Draft Audit Number 00029 of October 19, 2001. This Audit was a review of AT&T's Franchise Fee payments of July 1, 1998 through June 30, 2000. AT&T is in agreement that we correctly paid all franchise fees due the City and that we correctly paid the cash grants to the City.

AT&T is committed to working with the Department of Telecommunications and Information Services to develop terms that would be used to amend the franchise as it relates to the reporting of advertising revenue.

AT&T Broadband does not concur with the statement that AT&T has been in noncompliance with its franchise obligations for reporting advertising revenues. As the audit shows we paid the correct amount of franchise fees. The change in ownership of the franchise in San Francisco coupled with the dissolution of Bay Cable Advertising made the reporting guidelines in the franchise obsolete. In fact, if AT&T had attempted to follow those requirements it would have likely resulted in incorrect franchise fee payments to the City. In fact, at a meeting between AT&T Broadband and DTIS representatives Denise Brady and Brian Wilson on October 17, 2001 we discussed the need to change the language of the franchise.

AT&T Broadband remains committed to working with the City to amend the franchise but must continue to report revenue in such a way that allows us to pay the correct amount of franchise fees to the City.

Sincerely,

A handwritten signature in dark ink that reads "F. Kent Leacock".

F. Kent Leacock
V.P. Government Affairs & Franchising



cc: Mayor
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Budget Analyst
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